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IN THE
Supreme Court of the United States
OCTOBER TERM, 1985

CROCKER NATIONAL BANK,
Appellant,

v.

PAUL PERDUE,
Appellee.

On Appeal from the Supreme Court of the State of California

BRIEF OF AMICUS CURIAE CONSUMER BANKERS ASSOCIATION IN SUPPORT OF APPELLANT'S JURISDICTIONAL STATEMENT

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INTEREST OF AMICUS CURIAE CONSUMER BANKERS ASSOCIATION

Amicus Curiae Consumer Bankers Association ("CBA") was organized in 1919 to provide a voice for the retail banking industry. Membership in CBA is open to all federally insured depository institutions, including national and state-chartered banks, savings and loan associations and credit unions. CBA members currently hold over 80% of the consumer deposit accounts and over 70% of the consumer credit held by commercial banks nation-

wide. CBA's membership includes depository institutions in almost every state.[1]

The financial services industry is in the midst of a period of intense and unprecedented competition, engendered by the progressive congressional deregulation of the financial services industry since 1978 and by the specific congressional determination that depository institutions should pay market rates of interest on deposits. To respond effectively to these federal policies, and to the resulting pressures of the competitive marketplace, CBA members must have the flexibility to price deposit account services at levels sufficient to attract and retain deposits and to defray increased interest expense. The decision below, by authorizing individual trial judges to substitute their subjective judgments for the judgment of the freely competitive market with respect to the pricing of those services, will adversely affect the ability of amicus' members and all depository institutions to compete successfully in the marketplace.

Until this litigation, Congress' comprehensive scheme of deregulation was understood by the industry and interpreted by the legal community and the Office of the Comptroller of the Currency, amongst others, to preempt the type of state-law pricing restrictions applied by the court below. This case presents directly and unavoidably the question whether state law restrictions on deposit account service charges are preempted by federal law.

Because such restrictions threaten to radically alter the overall economics of the deposit account with serious implications for the ongoing safety, soundness, and competitiveness of federally insured depository institutions, amicus respectfully urges review by this Court at this time to resolve the substantial federal issues presented

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[1] Pursuant to Supreme Court Rule 36.1, amicus curiae CBA has obtained the written consent of counsel of record for all parties hereto to the filing of this brief.

and to provide needed certainty to the financial services industry.

SUMMARY OF ARGUMENT

Until this litigation, state review and modification of deposit account service charges, as approved by the decision below, was understood to be preempted as to all federally-insured depository institutions by federal banking statutes and regulations, and in particular by the 1980 and 1982 legislation deregulating the financial services industry. That legislation removed artificial ceilings on the rate of interest payable on demand deposit accounts and left determinations about the cost and flow of those deposits to the forces of the competitive marketplace.

In authorizing payment of market rates of interest on deposits, Congress necessarily recognized that the cost of funds to financial institutions would increase, and, therefore, that charges for servicing deposit accounts (charges which had previously been subsidized by paying below-market interest rates) would also increase to the extent permitted by competition. Depository institutions must be able to recover market costs on deposit account services in order to continue paying market rates of interest on those accounts. Congress expected that this "unbundling" of financial services and shift to explicit pricing would redound to the ultimate benefit of consumers, who would receive market returns on deposits and pay for only those services they used.

The decision below, holding that states may impose artificial, ill-defined and, even worse, *below* market limits on service charges, severely frustrates Congress' objectives in deregulating the financial services industry. Moreover, the decision below *directly contradicts* an interpretive ruling of the Comptroller of the Currency ("OCC") upon which the national financial services industry had every reason to rely. Worse, this direct refutation of the OCC regulation has created a general

uncertainty as to the reliability of similar preemption interpretations by the OCC and other federal regulators.

There is an immediate and compelling need for this Court to address the merits of the preemption issues raised by appellant. The decision below is part of a widespread challenge to depository institution service charges nationwide. Twenty-eight such cases are now pending in California. Similar litigation has already been initiated in Oregon and Alaska, and legislation has been enacted or is pending in other states that would prohibit depository institutions from charging market rates for their services. This appeal presents virtually the same preemption issues posed by all of these state-law efforts to limit depository institution service charges and affords this Court an opportunity to reconcile the answers to those issues with its consistent rulings on preemption in the area of federal banking law. Because of the vast sums involved and the nationwide character of the problem, CBA respectfully urges this Court to reach the merits of this appeal at this time.

ARGUMENT

I. The Decision Below Is Incompatible With Federal Deregulation Of The Financial Services Industry

In 1980 and 1982, Congress mandated a phase-out of long-standing restrictions on the rate of interest that federally insured depository institutions could pay on short term time deposits; Congress also authorized such institutions to begin to offer interest-bearing checking accounts (NOW Accounts) and money market accounts. Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 132; Garn-St Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, 96 Stat. 1469 (pertinent portions codified at 12 U.S.C. §§ 1832, 3502-3504). Congress recognized that as a consequence of its deregulation of the interest paid on deposits, financial services would become "unbundled,"

and depository institutions would begin to price explicitly deposit account services that had previously been subsidized by artificially low interest rates paid on deposits. Congress, therefore, fully expected that service charges on deposit accounts would increase as a result of the payment of market interest rates on those deposits. The decision below, by authorizing courts to require depository institutions to offer deposit account services at *below*-market fees while nonetheless paying market rates of interest on deposits, is fatally at odds with the federal goals of deregulation.[2]

As appellant notes, before 1980, federally insured institutions had been prohibited from paying market rates on time deposits of less than $100,000. 12 C.F.R. §§ 217.7, 329.6, 526.3 (*repealed* 1980). This had resulted in "disintermediation"—the flow of funds out of federally insured institutions into "money-market" funds paying higher, market rates of interest. Moreover, these pre-1980 restrictions had led banks to compete for deposits through "gifts, free services and more convenience," which had increased the cost of deposits. S. Rep. No. 368, 96th Cong., 1st Sess. 5 (1979). In acting to deregulate the industry in 1980 and 1982, Congress believed that "many depositors would prefer to receive interest income, which they can spend as they choose, rather than having to accept this implicit interest." *Id.*

As early as 1977, the Senate Committee on Banking, Housing and Urban Affairs stated in the context of hearings on NOW accounts that if all financial institutions were authorized to offer such accounts, "competition

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[2] The appellant's arguments herein are particularly persuasive. (Jurisdictional Statement 18-22) In addition to the 1980 and 1982 Acts, appellant relies on two sections of the National Bank Act, 12 U.S.C. § 24 (Seventh) and 12 U.S.C. § 484, as sources of federal preemption (Jurisdictional Statement 8-17). While limiting its discussion herein, amicus nonetheless believes that the cited sections of the National Bank Act represent independent sources for preemption contrary to the decision below.

for consumer deposits will be active, and should result in improved quality and variety of consumer financial services," S. Rep. No. 407, 95th Cong., 1st Sess. 8 (1977). This theme is consistently repeated throughout the legislative history of the 1980 and 1982 Acts. See, e.g., Competition and Conditions in the Financial System, Part I: Hearings Before the Senate Committee on Banking, Housing, and Urban Affairs, 97th Cong., 1st Sess. 51, 55 (1981) (benefits of competition vis-a-vis regulation) (remarks of Frederick H. Schultz, Vice Ch., Bd. of Gov. of the Fed. Res. System); *id.* at 31, 33 ("The ultimate beneficiary of [deregulation] would be the consumer or other user of depository institution services whose special conveniences could be more readily addressed.") (statement by Donald T. Regan, Secretary of the Treasury). See also id. at 63, 65 ("[O]ur present framework is increasingly out of touch with the market realities. What ever reform occurs elsewhere, the failure to address this issue will assure increasingly inefficient and costly regulation.") (statement of John G. Heimann, Comptroller of the Currency).

The Senate Report to the 1980 Act emphasized that Congress' intent in providing NOW account authority was to:

> allow financial institutions to compete with one another on the basis of price. The [then existing] prohibition against payment of interest on demand deposits on the other hand, necessitates nonprice competition which leads to inefficiencies and misallocations of scarce resources.

S. Rep. No. 368, 96th Cong., 1st Sess. 5 (1979). These views mirrored those of the Comptroller, who testified while the bill was still in committee that:

> the time has come to dismantle governmental restrictions which have outlived their usefulness and often serve only to protect inefficient competitors. *We must*

> *come to rely on the market mechanism* as the most efficient allocator of resources and determiner of prices. Substitution of governmental judgement for that of the depository institutions and the marketplace is arbitrary.

Depository Institutions Deregulation Act of 1979, Part II: Hearings Before the Subcom. on Fin. Institutions of the Senate Comm. on Banking, Housing and Urban Affairs, 96th Cong., 1st Sess. 89, 97 (1979) [hereinafter "Deregulation Hearings"] (emphasis added). It is respectively submitted that the decision below is precisely the type of arbitrary, non-price related judgment criticised in the foregoing statements.

In deregulating interest rates, Congress acknowledged that the removal of ceilings would lead to increases in bank services charges. For example, Senator Cranston stated in the Senate Report:

> It seems clear that if institutions are going to pay higher interest rates, and if market rate money market certificates are going to be available in $1000 denominations, that *institutions are going to have to charge more for the services they offer* and the money they lend.

S. Rep. No. 368, 96th Cong., 1st Sess. 39 (1979) (emphasis added).

Similarly, Senators Tower, Garn, and Lugar anticipated that:

> the payment of interest on transaction balances could ultimately result in an *"unbundling" in the pricing of financial services to the public.* This would result in the public *paying explicitly for services* and being explicitly paid, in turn, for funds provided to depository institutions

Deregulation Hearings, supra, Pt. I at 78 (emphasis added).[3]

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[3] Significantly, representatives of the financial industry testified regarding the upward pressure that deregulation would place on

In short, Congress fully appreciated that, to the extent competition permitted, banks would implement service charges on deposits in such amounts as were necessary to balance the competitive market rates paid on deposits. The decision below substantially thwarts this goal: it authorizes state courts to require a bank to offer services at something other, and even *less*, than their market price. In so doing, it substitutes the court for the competitive market as the regulator of prices. Thus, as appellant argues, state regulation of deposit account service charges frustrates the accomplishment and objectives of Congress, *Hines* v. *Davidowitz*, 312 U.S. 52, 67 (1941), and is, therefore, preempted.

Experience with deregulation confirms that Congress was justified in its reliance on the pricing mechanisms of the marketplace, unfettered by state interference of the kind contemplated and undertaken by the court below. Competition for deposits in the wake of deregulation has been vigorous. *E.g.*, N.Y. Times, Dec. 9, 1985, at 32, col. 6 (nat'l. ed.) ("continued competition for deposits"); American Banker, Oct. 22, 1985, at 29, 30, col. 4 ("competition for deposits has escalated"); Business Week, March 22, 1985, at 100, col. 2 ("competition . . . is fiercer than ever"); N.Y. Times, May 1, 1983, § 3, at 1, col. 3

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deposit account service charges. *See Deregulation Hearings, supra*, Pt. II, at 134, 143 (testimony of John H. Perkins and Robert W. Renner on behalf of the American Bankers Association) (depositors will be "paying more in service charges"); *id.* at Pt. III, 12, 29 (statement of J. Alvin George, Ch. Credit Union Nat'l Ass'n) ("the consumer will receive the full value of his money in the form of explicit interest, and will pay only for those services he 'consumes' "); *id.* at 171, 172 (statement of Thomas F. Bolger, 1st V.P. Independent Bankers Ass'n) ("the increased costs of NOW accounts will force institutions offering them to go to explicit pricing of all their services, and it is inevitable that service charges . . . will be increased for regular checking accounts as well as NOW accounts").

("brutal competition"); American Banker, May 19, 1982, at 4, col. 3 ("marketing warfare"). Moreover, as Congress anticipated, competition for, and higher returns on, deposits go hand in hand with explicit pricing of bank services. N.Y. Times, Sept. 20, 1985, § A at 30, col. 1 ("What customers are discovering in return [for higher interest deposits] is that they must pay the full cost of the services they receive.")

Competition for deposits has not been limited to interest rates, but also extends to service charges, including NSF charges. A recent study by the Staff of the Board of Governors of the Federal Reserve System concludes that:

> [w]hen shopping for banking services, consumers face a *complex array of service options and charges*, especially for checking accounts. The *level of service charges for each service varies widely* within and among bank size categories as well as by geographic location.

Canner & Kurtz, *Service Charges as a Source of Bank Income and Their Impact on Consumers*, Federal Reserve Board of Governors Staff Study No. 145 at 17 (1985) ("Fed. Res. Study No. 145") (emphasis added). Similarly, a nationwide survey conducted last year by the Consumer Federation of America, while generally critical of bank service charges, nonetheless reports that NSF charges at the 91 institutions surveyed ranged from $7 to $20, with a typical charge of $10 or $15. *Bank Fees on Consumer Accounts: A 10-State Survey* (May 17, 1984).

The Federal Reserve Staff Study emphasizes that recent service charge increases must be viewed against the "dramatic" rise in banks' interest expense attributable mainly to the 1980 deregulation act. The Study observes that:

> [a]s a result of higher expenses, the net return to banks on personal checking accounts in 1983 was either about the same or somewhat lower than in 1979, depending on bank size . . . This finding suggests that *the increase in service charges and fees over the period was just sufficient to maintain a nearly constant return to banks* for providing the average personal checking account.

Fed. Res. Study No. 145 at 6 (emphasis added). Indeed, the Study goes on to note that, notwithstanding these increases, "service charges and fees were a relatively more important source of personal checking account revenue before the 1980 Deregulation Act then they were in 1983." *Id.* at 7.[4]

It is also noteworthy that in 1983, the "break-even balance"—the average balance needed to generate sufficient interest income to cover the costs of offering a personal checking account—was $1,380 for interest-bearing checking accounts and $692 for non-interest-bearing checking accounts. *Id.* at 8. The substantial overall costs of providing checking accounts and the competitive pressures engendered by deregulation attest to the wisdom of appellant's arguments (Jurisdictional Statement 11) and Congress' intentions. Depository institutions must retain the requisite flexibility to price services to offset the costs of the account, limited solely by the constraints of the competitive marketplace, not by judicial fiat as in the case below.

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[4] The Study concludes that service charges and fees represented on average 18% of bank income on personal checking accounts in 1983, compared with 19.3% in 1979. *Id.* at 8. Average monthly income per personal checking account, including fees and service charges, was $1.91 in 1983; excluding service charges and fees, the average personal checking account would generate a loss of $1.72 per month. *Id.* at 7.

II. The Decision Of The Court Below Is Inconsistent With Prior Preemption Determinations By This Court, The Lower Courts And The Federal Regulatory Agencies

While this case is clearly distinguishable on its facts, and involves other aspects of banking practices, the holding below appears inconsistent with the approach of this Court and others in ascertaining the relationship between federal and state laws affecting financial institutions.

This Court has numerous times affirmed the preeminence of the policies of the National Bank Act over conflicting state law. See, e.g., *Franklin National Bank v. New York*, 347 U.S. 373 (1954) (state law limiting national bank advertising preempted); *Tiffany v. National Bank of Missouri*, 85 U.S. (18 Wall.) 409 (1874) (national banks may export home-state interest rates notwithstanding contrary state law.)

More recently, this Court has acknowledged the preemptive effect of agency regulations under the Home Owners Loan Act. *Fidelity Federal Savings and Loan Association v. de la Cuesta*, 458 U.S. 141 (1982) (state laws restricting due-on-sale clauses preempted). See also, *Conference of State Bank Supervisors v. Conover*, 710 F.2d 878 (D.C. Cir. 1983) (similar preemptive effect given to regulations of the Comptroller of the Currency); *Federal Home Loan Bank Board v. Empire*, —— F.2d —— (10th Cir. 1985) (state advertising restrictions inapplicable to federal savings associations).

Similarly, the case below directly contradicts the Comptroller of the Currency's Interpretative Ruling 7.8000, 12 C.F.R. § 7.8000 ("the Ruling") regarding the imposition of service charges by national banks. The Ruling recognizes the primacy of marketplace pricing and the longstanding federal law occupation of the area of deposit account banking services. The Ruling em-

braces principles expressly recognized by the OCC and relied upon by the banking industry for over 20 years.[5]

These cases and rulings suggest that this Court, lower federal and state courts, and the regulatory agencies have in the past given considerable weight to the policy objectives of the federal banking laws, as against the regulatory activities of the states. The financial services industry has, in turn, come to rely on the primacy of federal pronouncements in this area. These facts underscore the need for prompt review of this case. If the decision of the California Supreme Court stands unchallenged, the scope of those earlier determinations is brought seriously into question, interstate banking activity is substantially burdened, congressional objectives are thwarted, and unjustifiable harm may be visited nationwide upon the financial services industry.

III. The Problem Presented In This Case Is National In Scope

Though this case comes to this Court on appeal from a decision of the Supreme Court of California construing a California statute—California Civil Code § 1670.5, the preemption issues raised herein have nationwide significance. In addition to the 27 similar cases now pending in California, there are two NSF cases now on appeal in the Oregon state courts. Another two cases have recently been filed in Alaska. All of these cases include claims that defendant's charge for processing NSF checks exceeds the cost of providing the service to an unconscion-

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[5] Amicus CBA concurs with the detailed arguments on these points framed by the amicus brief filed by the OCC herein. In particular, amicus CBA respectfully directs the Court's attention to the discussion therein of *Jacobs v. Citibank, N.A.*, 92 A.D. 2d 786, 459 N.Y.S. 2d 781 (App. Div. 1983), *aff'd*, 61 N.Y. 2d 869, 462 N.W. 2d 1182, 474 N.Y.S. 2d 464 (1984) where it was decided that the Ruling preempted state law restrictions on NSF charges levied by national banks located in New York.

able extent. Because other jurisdictions recognize the doctrine of unconscionability codified at Section 1670.5 of the California Civil Code, amicus expects that additional cases will be filed, especially if this Court refuses to hear this appeal.

Nor are efforts to limit the levels of depository institution services charges restricted to the courts. Illinois has recently enacted legislation on the subject. Ill. Rev. Stat. Ch. 22, § 3806 (1985). Legislation is also currently pending in Pennsylvania that would impose price ceilings on various services associated with checking accounts.

These and other judicial or statutory limitations on deposit account service charges that may follow on the heels of the decision below raise the same preemption issues that are presented on this appeal. They threaten a massive disruption of the national marketplace through the erection of a patchwork of arbitrary and inconsistent restrictions. Given the large sums that are potentially at issue and the substantial litigation expense involved in such suits (especially in the California litigation that has been pending since 1977), the safety and soundness of the federally insured depository system may be severely eroded. As a result, there is extraordinary need for this Court to address the permissibility of state regulation of deposit account service charges at this time.

CONCLUSION

As discussed herein and in appellant's jurisdictional statement, the court below erred in concluding that state regulation of deposit account service charges was not preempted by federal law. Nevertheless, that decision is controlling in California, and is potentially persuasive authority elsewhere. Because the validity of state regulation of depository institution service charges affects depository institutions and their customers nationwide,

amicus CBA respectfully urges this Court to address the merits of this appeal.

Respectfully submitted,

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